## Morocco and the European Union: The economics of association


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# Morocco and the European Union: the economics of association

### *Introduction*

On 26 February 1996, Morocco and the European Union (hereafter referred to as the EU) signed an Association Agreement. This association forms part of the *Euro-Mediterranean Partnership*, which was established at Barcelona on 27-28 November 1995, at a meeting between the EU and the majority of the non-European Mediterranean countries. It is known in Euro-speak as the 'Barcelona Process'. The agreement, which came into effect on 1 March 2000, should lead to the creation of a free-trade area by the year 2010. This will give Morocco free access to EU markets, at least as far as industrial products are concerned. The agreement also aims to achieve the progressive liberalization of trade in agricultural and fishery products, but without any firm commitment by the parties concerned. It also requires Morocco and the EU to explore ways of liberalizing trade in services, above and beyond their WTO (World Trade Organization) obligations.

What benefits can Morocco expect from this association? In order to answer this question, we will start with some background information on international trade theory, with an application to Morocco's trading situation. We will then proceed to discuss the process of trade liberalization. This, in turn, is followed by an analysis of the problems associated with Morocco's economic integration with other countries. The next section deals with the costs and benefits deriving from the Association, and from a higher degree of integration in the world economy in general. From here we move on to examine the preconditions that must be fulfilled if this integration is to be successful. The final section draws conclusions on the basis of the discussions and empirical data contained in the preceding sections.

### *International trade*

The positive effects of international trade can be said to derive from three sources. Firstly, specialization dictated by comparative advantage. If countries, like individuals, specialize in those activities at which they excel, or are most efficient, then production and income will be maximized. This is explained by the Ricardo and Heckscher-Ohlin models, which form the core of international trade theory.[1] Secondly, economies of scale. Free trade provides opportunities for large-scale production, as well as the chance to exploit the economies of large-scale production, i.e., to reduce the production and marketing costs per product unit. Thirdly, competition effects. When borders are open-

1 See, for instance, Krugman and Obstfeld (2006) 26, 50, 76.

ed, competition increases. This means that firms will have to constantly improve the goods and services they produce, to prevent their customers from shifting their allegiance. The same applies to these companies' production technology and marketing methods.

In view of these benefits, why is there no free trade on a global scale? There are basically three reasons for this. Firstly, trade affects the distribution of income. If we liberalize trade and import more goods produced using unskilled labour, while at the same time exporting more goods produced with highly skilled labour, this will have several effects. The demand for poorly-skilled labour falls, the demand for highly-skilled labour increases, and the wage gap between the two will widen. This may then result in attempts by trade unions to prevent trade liberalization.

Secondly, when a country liberalizes trade, industries competing with the imported goods will suffer. This will cause some firms and industries to contract, while others may even disappear completely. People will have to be retrained. There may be an anxiety that new jobs are not being created fast enough to compensate for the disappearance of the old ones. Again, those affected will resist liberalization. A very curious case of resistance against freer imports occurred in the mid-1990s, when tomatoes from Morocco were granted freer entry into the EU. Fully aware that this would impinge on their profit margins, tomato growers in the EU conducted a successful lobbying campaign in Brussels. It was subsequently ruled that, in the month of April, the door would be closed to Moroccan tomatoes[2]. The reason for this was that, in April, EU tomato production is low and prices are high. The ban on Moroccan tomatoes enabled EU tomato growers to fleece the consumer in times of scarcity.

Thirdly, trade restrictions in the form of import tariffs also serve an entirely different purpose, the generation of tax revenue. The perception costs of import tariffs are likely to be substantially lower than those associated with income tax or a turnover tax. Poor countries in particular, including Morocco in the early 1980s, often derive some thirty per cent of their total tax income from import tariffs.[3]

There is no question that international trade is essential to Morocco's welfare. It has a comparative advantage in phosphates, a number of agricultural products, and the simpler kinds of industrial processes, such as garment manufacture and electronics assembly. Morocco's export revenue derives mainly from these products and activities (see Table 1). It is better to specialize in these areas and import those industrial products that require highly skilled labour and a large amount of capital and/or are dependent on high volumes for efficient production. A case in point is truck assembly. In the year 2000, some two thousand trucks were assembled in Morocco by no less than nine producers. This is a waste of resources.[4]

It serves as a reminder that Morocco is a relatively small market. In 2003, Morocco had 30.6 million inhabitants and its gross domestic product or GDP amounted to €39 billion (bn). By comparison, the Netherlands had 16.2 million inhabitants and a GDP of

2 *Trouw* (1995).

3 Ebrill, Stotsky and Gropp (1999).

4 WTO (2003) 85.

$454 bn. For most industries, the domestic market is simply too small for them to be able to exploit economies of scale. Trade liberalization is of the essence. Products which are expensive to produce in Morocco should be imported. This will free up production factors that can be used to better advantage in the export industries.

*Table 1. Morocco, percentage share of commodity exports, 1995 and 2002*

| | 1995 | 2002 |
|---|---|---|
| textiles | 31 | 40 |
| agriculture | 32 | 20 |
| electronics | 3 | 17 |
| fertilizer (phosphates) | 9 | 3 |

*Source: Söderling (2005).*

The EU is the country's natural partner when it comes to international trade. In 2003, the EU accounted for no less than 71% of Morocco's exports and 58% of its imports.[5] It is a sad fact that the EU has not allowed Morocco to fully exploit its comparative advantage. Under the Association Agreement, industrial imports from Morocco have unrestricted entry into the EU, but there has been little progress on trade in agricultural goods. The trade agreement of October 2003 imposed tariff quotas on a number of products, such as tomatoes. This means that imports carry a low tariff, possibly even a zero tariff, up to a certain volume. Additional imports are subject to a higher tariff.

Such agreements are only concluded for short periods. This uncertainty does little to stimulate investment. A fisheries agreement, for example, which was due to take effect on 1 March 2006, is only valid for a period of four years. The agreement regulates the activities of EU fishing fleets – mainly Spanish and Portuguese – in Moroccan waters. It contains detailed stipulations regarding the percentage of the catch that has to be unloaded on Moroccan soil. This was in response to Moroccan demands, which were aimed at boosting employment and tax income. In addition, it was hoped that the measure would stimulate the development of local fish processing industries.[6] However, it remains to be seen whether or not people will be willing to make substantial investments on the basis of an agreement with a lifetime of just four years. As for services, prior to 2005 the EU had not even started to think seriously about discussing the subject.

5 European Commission (2005). Trade statistics should be taken with a grain of salt. Exports of goods from Morocco officially totalled €8230 million over 2003, European Commission (2005), but illegal drugs exports are estimated to have brought in no less than €3 billion, Bergh (2005) 9.

6 *L'économiste* (17 July 2005, 23 December 2005).

### *Trade liberalization*

The import of Moroccan industrial products into the EU had already been liberalized before the 2000 Association Agreement was concluded. So one might well ask 'What is in it for Morocco?' After all, Morocco will bear the brunt of the necessary adjustments. It is under an obligation to liberalize its imports, especially those involving industrial products. Nevertheless, countries generally benefit considerably from import liberalization. In the past, Morocco has used quite high rates of protection. According to 2002 figures from the World Bank, the weighted mean import tariff in Morocco was 25.8 %, against 1.80% for the EU. If anything, this still paints a too favourable picture.[7] Some goods are subject to prohibitively high tariffs. The maximum rate was a whopping 339%.[8] As a result, the goods that fall under this tariff scarcely figure among the country's imports. This means that they are not included in the weighted average, which is therefore subject to a downward bias. Such high levels of protection are detrimental to a country's welfare. They enable inefficient industries to survive. This in its turn makes life harder for industries operating in those areas in which a country has a comparative advantage.

Three mechanisms are involved. The first derives from the fact that protection results in reduced demand for foreign goods, which in turn causes a reduction in the demand for foreign exchange. Accordingly, the external value of the country's currency will be higher than it would have been under free trade conditions, which means that exports suffer. Secondly, more labour and capital remain tied up in the protected sectors, which translates into higher labour and capital costs in the other sectors. Thirdly, potential exporters see their competitiveness impaired by the higher cost (or sheer unavailability) of imported inputs. In the case of Morocco, agricultural exporters have suffered from the high prices of such imports as tractors and seeds, which are a direct result of import duties. As a result, a large number of industries have seen their growth reduced by the unavailability of inputs.[9]

In Morocco, things are made even more complicated by the enormous variation in import tariffs. This leads to a completely opaque structure of effective protection. Effective protection differs from nominal protection (import tariffs on goods), in that it refers to the protection of domestic activities, taking account of tariffs on imported raw materials or semi-finished products. Consider the case of carpenters involved in the manufacture of tables. The amount of timber required to make one table costs $100 on world markets, whereas complete tables cost $200 on world markets. If timber is subject to a 5% import tariff and complete tables are charged 10%, then the domestic price of the imported timber is $105 and the domestic price of an imported table is $220. The work of transforming the timber into a table can cost up to $115 before domestic carpenters lose the fight against imports. This means that the effective protection on domestic activity is 15%, which is higher than the nominal tariff on tables. However, if

7 *Economic Review of EU Mediterranean Partners* (2003) 7.
8 WTO (2003) Statistical Appendix Table AIII.3.
9 Bergh (2005) 8.

timber is subject to a 15% tariff, for example, while tables only carry a 5% tariff, the result is negative effective protection. Imported timber will cost $115, while imported tables cost $210. Domestic carpenters will therefore be handicapped, since they can charge no more than $95, which is $5 less than their colleagues abroad receive.

It may very well be that activities in areas where Morocco enjoys a comparative advantage cannot prosper because of adverse effective protection. According to the WTO and the IMF (International Monetary Fund), the existing tariff structure stacks the odds against industries producing semi-finished products, in which Morocco is said to have a comparative advantage[10]. However, it might be more accurate to say that Morocco has a comparative advantage in the area of relatively simple industrial processes. In the textile industry, for instance, there is considerable outsourcing and/or intra-firm trade by Spanish and British firms. This means that there are substantial imports of intermediate goods from Spain and Britain, and that the finished goods are exported to these same countries. The export of finished textile products to the UK and Spain increased 18-fold and 26-fold respectively, in nominal terms, between 1995 and 2002.[11]

Morocco will undoubtedly benefit from the phasing out of import tariffs on industrial goods. However, the sequencing of this process will involve adverse side effects. This is because the tariffs for final products – an area in which Morocco has no comparative advantage, at least not for sophisticated goods –, will be the last to go. As a result, these products will continue to receive protection while others do not, which will give false signals to producers.

While the effects of import liberalization are generally beneficial, as we have seen, there may be a cost in terms of tax income foregone. In the year 2000, import tariffs accounted for 4.8 % of GDP, or 17.9 % of government income.[12] If import tariffs are to be drastically reduced, then Morocco needs to find other sources of tax revenue. The problem appears to be manageable, however. Since 1988, increases in the amount of VAT (Value Added Tax) collected on imported goods at the country's borders seem to have matched the reduction in import tariffs, thanks largely to increased international trade.[13]

***Problems of economic integration***

The phasing out of import tariffs is not the only measure that will help Morocco improve its economic performance. The country is also adopting a large part of the EU *acquis communautaire*[14] in fields such as intellectual property, competition policy and government subsidies. This will impose a temporary, but nevertheless heavy, administrative burden. However, it will also make for a more efficient economy, in which clear rules are observed. It will, furthermore, reduce the risk of Morocco becoming involved in trade disputes with other countries as a result of 'unfair' trade practices. Even with these mea-

10 WTO (2003).
11 Söderling (2005).
12 IMF (2003) 18.
13 Bergh (2005) 8 nt. 17.
14 The body of EU legislation and regulations.

sures, however, the risk of such disputes cannot be completely excluded. Aside from its free trade agreement with the EU, Morocco has entered into a similar agreement with EFTA, the European Free Trade Association, which is made up of Iceland, Liechtenstein, Norway and Switzerland. The country opened other avenues to free trade in 2004, when it signed the Agadir Agreement together with Jordan, Tunisia and Egypt. In that same year, Morocco also concluded bilateral free-trade agreements with Turkey and with the United States. The latter deal, which is to be implemented in the period from 2006 to 2021, is particularly likely to result in all kinds of complications.

Consider the following case. Under their bilateral free-trade agreement, Morocco imports certain goods from the US, free of duty. However, these same American goods are subject to an import tariff when they enter the EU. In this situation, traders would be tempted to import the goods into Morocco free of duty, and then to re-export them to the EU. This phenomenon is referred to as *deflection of trade*, and such imports are not welcomed by the EU. The EU therefore requires *certificates of origin*, stating that at least some minimum percentage of the added value of the goods in question originates from Morocco. The US naturally operates a similar scheme. Aside from being extremely expensive in terms of the administrative burdens that they impose, these measures open the way to corruption and may also sour relations with trade partners. People will always try to cheat.[15] In fact, the rules of origin included in the various free trade agreements concluded by Morocco are very diverse. This is not helped by the complex structure of import tariffs. The World Bank and the IMF have put pressure on the Moroccan government to harmonize and simplify the system.[16]

There is one bright spot, however. The EU wants to stimulate trade between the Mediterranean countries and to counteract the hub-and-spoke effects that have characterized trade ever since French colonial rule.[17] It therefore allows what is referred to as the *cumulation* of certificates of origin. This means that the minimum requirements pertaining to the sources of added value include value added in other Mediterranean countries, a rule which applies to the Agadir Agreement, for instance. While this is undoubtedly a step in the right direction, in itself it is not sufficient to bring about an intensification of trade between the Mediterranean countries. Morocco and its neighbours could do much more in this respect. In the year 2000, four neighbouring countries provided no more than 2.5% of Morocco's imports and took a measly 1.9% of its exports.[18] More regional liberalization and integration would create opportunities to exploit the economies of scale. Such steps would also make the region more attractive for direct foreign investment, which would help to introduce better technology, management and marketing. Between them, the three Maghreb countries of Algeria, Tunesia and Morocco

15 More on the problems associated with free-trade areas and the points of difference with customs unions in Visser (2004).

16 *L'économiste* (13 December 2005), IMF (2005a) 15.

17 This refers to the fact that there has been very little trade between the Maghreb countries; most trade has been with France, which is seen here as the centre or hub.

18 WTO (2003) 22.

have more than 75 million inhabitants. The importance of this fact is that there is solid evidence that larger regional economic areas tend to attract more direct foreign investment.[19]

Cooperation beween the Maghreb countries was slow to take off, but it seems to be gathering pace at last. A conference on trade facilitation in Algeria, Morocco, and Tunisia was held in Algiers on November 21-22, 2005. Those attending included ministers, the presidents of various central banks, and the managing director of the IMF. Working groups were set up to formulate proposals on issues relating to closer regional economic cooperation. One such issue concerns the harmonization of trade regulations linked to the implementation of free trade agreements, with particular reference to procedures and rules of origin. Other issues are the modernization of administrative procedures within the customs service, the streamlining of document processing, the improvement of cross-border payment systems, and a review of logistical chains, including transportation. Dates have been fixed for follow-up meetings and there seems to be a fair chance that the respective governments will keep up the momentum, perhaps with some prodding from the IMF and the World Bank.

***What can be expected from trade liberalization?***

Full-scale model estimates of the benefits of economic association with the EU are few and far between. An idea of the quantities involved can be gleaned from a World Bank study of Tunisia, which is also involved in the Barcelona Process.[20] The static reallocation effects of association with the EU were estimated to permanently increase GDP by 1.7 per cent. These effects derive from the reallocation of economic resources to bring them more into line with the country's comparative advantage. In addition, there are dynamic effects, resulting from economies of scale and from the effects of harmonizing health and technical regulations that were forced upon Tunisia by the European Union. Another factor is the increased trading efficiency brought about by improved financial, telecommunication and transport facilities, which were upgraded with EU assistance. The gains for Morocco are likely to be of the same order of magnitude, with the static gains in one study estimated to be in the range of 1.5 – 2 per cent.[21] It should be noted that the effects may turn out to be much larger in reality. This is because the World Bank study did not address the effects of increased competition from abroad, such as the adoption of best practices, improved technologies, and better marketing techniques from other countries.

It will take time to reallocate resources between the various branches of industry. Nor can it be assumed that this process will be entirely cost-free, in terms of frictional unemployment. Rutherford *et al.* expected that it would take a full five years before any static reallocation effects become visible.[22] When labour and capital have to move from one

19 Jaumotte (2004).
20 Rutherford *et al.* (1995).
21 Rutherford *et al.* (1993).
22 Rutherford *et al.* (1993).

industry to another, the expansion of new industries may very well lag behind the contraction of old ones. Firstly, businessmen have to exploit new opportunities created by trade liberalization and secondly, part of the labour force will have to be retrained. Rutherford *et al.* estimated that the cost of such retraining was roughly equivalent to one year's salary.

The reallocation of labour may be especially difficult in poor agricultural districts. Under the free trade agreement with the United States, import tariffs on cereals, which run at up to 100 per cent, are to be phased out. It has to be said that cereal production in Morocco is not very efficient. It takes up scarce resources, water in particular, that would give higher yields if channelled into the production of other goods. Nevertheless, the World Bank has expressed concern that duty-free imports of cereals from the United States will only serve to exacerbate rural poverty. The Moroccan government has been singularly slow in preparing support measures for those affected.[23]

These costs must be balanced against the additional benefits that can be expected from trade liberalization, over and above the efficiency gains from production which exploits the country's comparative advantage. These benefits accrue from the possible reduction of 'rent-seeking activities', which would free up resources for more productive activities. What are 'rent-seeking activities'? In a system of regulated trade, politicians and civil servants have discretionary power over the granting of import permits and tariff exemptions. Import licenses and exemptions are important sources of income. Import restrictions reduce the supply of goods, which means that higher prices can be charged. If the reduction of supply is brought about by a licensing system rather than import duties, there will be a large gap between the prices paid by importers and the prices they can charge on the domestic market. They will receive a much higher price than is required for them to stay in the market, in other words, they earn a 'rent'. The same applies to exemptions from import duties, of course. Licenses and exemptions have a monetary value, so importers will devote time and other resources trying to secure them. From the point of view of society as a whole, such 'rent-seeking activities' are extremely wasteful. Moreover, they easily result in shady dealings. Politicians and civil servants grant permits and exemptions, then pocket a share of the 'rents' created by the import restrictions as payment. Even if they can withstand the temptation to accept a bribe, their control over import restrictions gives them considerable power. Such power is seldom used to allocate licenses in an equitable and efficient way. There tends to be a coterie of politicians, civil servants and leading traders, to which small businessmen have no access. Furthermore, the whole system is detrimental to efficiency. Entrepreneurs are compelled to divert time and energy into maintaining good contacts with the state bureaucracy, to the detriment of innovative activity.

23 *L'économiste* (25 January 2005).

*Additional requirements for success*

International trade theory is unclear about whether trade should be seen as an engine of growth or as nothing more than its handmaiden.[24] Perhaps this question will never be satisfactorily answered. This is because, in the peculiarly un-erotic universe of the metaphors that make up a large part of economic theory, it is difficult to distinguish 'handmaidens' from 'engines'. But even assuming that trade is an engine, it would only run in fits and starts unless a number of conditions are fulfilled.

First of all, while Morocco has concluded various free trade agreements, this does not necessarily mean that trade is genuinely free. Trade in manufactured goods with the EU may indeed leave less room for the restrictions that create 'rents'. Nevertheless, there are still plenty of opportunities to impose such restrictions in trade with other countries, and in agricultural trade. Not only does this hinder trade, it also impedes the development of industries that are able to compete on world markets.

Furthermore, trade liberalization must be accompanied by similar liberalization on the domestic front, to bring about an efficient allocation of resources. More importantly still, this will allow talented individuals to give full rein to their entrepreneurial abilities. Domestic liberalization includes a reduction of the costs of doing business, mainly by doing away with red tape. It may also include the privatization of government enterprises. Unfortunately, this does not always help to create the sort of competitive environment in which entrepreneurs are constantly introducing innovations: new products, new production methods, new markets, new sources of supply of raw materials or semi-finished goods, or the re-structuring of an industry. Such Schumpeterian 'new combinations' are essential to ongoing economic development.[25] It is all too easy, and unfortunately all too common, for governments to sell assets cheaply to favoured buyers. During the late 1980s, some thirty large families with close ties to the royal palace in Morocco seem to have profited in this way.[26] This favours the development of oligopolies, in which individual firms are left in peace in their cosy corner of the market. They have little incentive to innovate and create new jobs. There are signs, however, that the privatization that has taken place in recent years has been more successful. In addition, foreign investors are taking up a large proportion of the assets put up for sale.[27]

Furthermore, there is the question of education. According to World Bank figures, in 2002 illiteracy rates in individuals above the age of 14 were 37% for males and 62% among females.[28] Moreover, the emphasis on Arabic, coupled with a neglect of French and other foreign languages, means that education is not well geared to the needs of a developing economy. Nor does it help that there are no less than four different ministries of education.

24 Linnemann (1996).
25 Schumpeter (1969) 66.
26 Bergh (2005) 9.
27 Bergh (2005) 9 nt. 21.
28 www.worldbank.org->Morocco->dataprofile

There are other requirements for faster economic development and job creation, which we can only mention in passing here. One is a sophisticated financial system that is subject to clear rules and efficient supervision. A further cause for concern is the limited availability and high cost of credit for small and medium-sized enterprises.[29] An efficient, low-cost transport infrastructure is also essential for economic growth, yet the charges levied for the use of Moroccan ports are outrageously high.[30] Things are likely to improve, however, as the Tanger-Med (Tanger-Méditerranée) port complex, which will be accessible to ships carrying up to 2000 containers, is nearing completion.

***Final observations***

There is every reason to believe that Morocco will benefit from the Association Agreement, but not to the full extent possible. The EU should liberalize imports of agricultural products and, for its part, Morocco could do more to stimulate trade with its neighbours. Furthermore, the country can only fully profit from liberalization if domestic markets are also opened up, and if entrepreneurs are not hindered by excessive red tape. In addition, educational levels are too low for Morocco to profit fully from the opportunities provided by more openness. While the liberalization of trade helps to fight poverty, it is by no means a panacea. This is a vital first step, nothing more.

When compared to developing countries as a whole (see Table 2) and to its neighbour Tunisia in particular, Morocco's economic growth to date has been quite lack-lustre.[31]

*Table 2. GDP Growth, 1971–2004 (in percent)*

| | Real GDP growth | | Real GDP per-capita growth | |
|---|---|---|---|---|
| | Morocco | Developing countries | Morocco | Developing countries |
| 1971–2004 | 3.81 | 4.47 | 1.75 | 2.58 |
| 1971–1982 | 4.75 | 0.74 | 0.09 | 2.58 |
| 1982–1991 | 4.32 | 3.75 | 2.16 | 1.80 |
| 1991–1998 | 2.11 | 4.20 | 0.42 | 2.51 |
| 1998–2004 | 3.33 | 5.35 | 2.05 | 3.84 |

*Source: Morocco: Selected Issues, IMF Country Report No. 05/419, p. 6; based on Moroccan National Accounts; WEO database; and IMF Staff estimates. The group of developing countries encompasses 152 nations.*

29 IMF (2005a) 16.

30 *L'économiste* (13 December 2005). For a more comprehensive review of recent developments see *10 Years of Barcelona process* (2005).

31 IMF (2005b) 6.

Although badly affected by a series of droughts in the 1990s, growth has now picked up again. It is difficult to say how much of the increase in growth is due to the impact of the Association Agreement with the EU. However, econometric studies have revealed a positive relationship between Morocco's increased openness in trade and its economic growth.[32] The official unemployment figures have dropped steadily from 14.5 per cent in 1999 to an estimated 10.8 per cent in 2004. However, the latter figure disguises the fact that urban unemployment stood at 18.4 per cent in 2004.[33] There is still a long way to go and one can only hope that the groundwork for sustained growth has been laid.

32 IMF (2005b) 27. Trade openness is the ratio of this volume of trade (real exports plus imports) over GDP, adjusted for the size (area and population) of the country, per capita GDP, whether it is landlocked, and whether it is an oil exporter.

33 IMF (2005b) 62.

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